



**Americans for Financial Reform**  
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November 26, 2012

Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, NW.  
Washington, DC 20551  
RIN 7100 AD74

Robert E. Feldman, Executive Secretary  
Attention: Comments/Legal ESS  
Federal Deposit Insurance Corporation  
550 17th Street, NW.,  
Washington, DC 20429  
RIN 3064-AD79

Office of the Comptroller of the Currency  
250 E Street SW  
Mail Stop 2-3  
Washington, DC 20219  
RIN 1557-AD43

Re: Margin and Capital Requirements for Covered Swaps Entities [RIN 1557-AD43; RIN 7100 AD74; RIN 3064-AD79]

To Whom It May Concern:

American for Financial Reform (“AFR”) appreciates this opportunity to comment on Margin and Capital Requirements for Covered Swaps Entities (the ‘Proposed Rule’). AFR is a coalition of more than 250 national, state, local groups who have come together to advocate for reform of the financial sector. Members of the AFR include consumer, civil rights, investor, retiree, labor, religious and business groups along with prominent independent experts.

A central goal of the Dodd-Frank Act is to minimize the likelihood that instability in the derivatives market will lead to a systemic crisis. This is done by requiring clearing where possible and appropriate, and adequate margin for those swaps that remain uncleared. The requirement that uncleared swaps be properly margined – the task of this Proposed Rule – is a vital element of financial reform.

The Proposed Rule contains a number of important steps that AFR supports. These include:

- Clear requirements that margin be posted for swaps between key financial institutions such as swaps entities and larger banks.
- The requirement that covered swaps entities set some limit for unmargined credit exposures to all counterparties, including commercial end users eligible for the clearing exemption.

As the Proposed Rule points out, this requirement simply replicates current and accepted market practices in well managed financial institutions. It is also consistent with the plain language of the Dodd-Frank Act. While the Dodd-Frank Act includes a clearing exemption for non-financial end users, it does not contain any general exemption for commercial end users from posting margin for uncleared swaps.

- A specific regulator-set limit for unmargined credit exposures to so-called ‘low risk financial end users’.
- The application of margin requirements to any transactions with an entity guaranteed by a U.S. person or an affiliate of a U.S. person, regardless of location globally. This is a vital step that is necessary to prevent evasion of key derivatives rules.

However, the Proposed Rule is also inadequate in several areas.

**One-way vs. bilateral posting of margin:** The Proposed Rule requires only one-way margin collection by swaps entities from customers, instead of bilateral margin postings by both the swaps entity and the customer. This conflicts with the recent CPSS-IOSCO recommendations.<sup>1</sup> Swaps entities should be required to post as well as to collect margin. Omitting this requirement significantly increases systemic risks due to financial contagion in the event of the failure of a major derivatives dealer.

The Agencies ask several questions related to this issue:

Question 28. Would requiring a covered swap entity to post initial margin to end user counterparties reduce systemic risk (e.g., by reducing leverage in the financial system or reducing systemic vulnerability to the failure of a covered swap entity)?

Requiring bilateral posting would reduce overall leverage in the financial system, and would reduce losses to customers and taxpayer exposure in the event of the failure of a major financial

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<sup>1</sup>Bank of International Settlements, “[Margin Requirements for Non-Centrally Cleared Derivatives – Consultative Document](#)”. July, 2012.

entity. One-way posting of margin protects the bank from the customer's failure but may not protect the customer from the failure of the bank. Since the impacts of bank failures on real economy customers are clearly a major channel of transmission for financial distress, creating additional protection through bilateral postings would reduce systemic vulnerability.

Question 31. Would requiring a covered swap entity to post initial margin to end user counterparties remove one or more incentives for that covered swap entity to choose, where possible, to structure a transaction so that it need not be cleared through a CCP in order to avoid pledging initial margin?

Yes. Requiring bilateral posting of initial margin for uncleared swaps would reduce incentives for swaps entities to evade regulatory requirements to clear through a CCP that required initial margin. A bilateral posting requirement would mean that swaps entities would be required to supply initial margin regardless of whether a swap was cleared or uncleared.

Question 32. Would this approach be consistent with the statutory factors the Agencies are directed to take into account under sections 731 and 764 of the Dodd-Frank Act?

Yes. The statutory factors direct the Agencies to consider impacts on the stability of the broader financial system. This includes preventing financial contagion that may affect customers of major swaps entities.

**Consideration of lower margin requirements for 'low-risk' swaps entities:** The Agencies request comment on whether the Proposed Rule should establish a distinct category of covered swap entities that because of their limited derivatives activities would be subject to less stringent margin and segregation requirements. AFR would oppose establishing such a category. A bank dealing in derivatives should follow sound risk management practices. This is true even if the derivatives exposure is below the rather high levels established as thresholds for entity designation by Commodity Futures Trading Commission (CFTC) and the Securities Exchange Commission (SEC).<sup>2</sup> Sound risk management practices include both posting and collecting margin.

In addition, the determination that smaller entities would be permitted lower margin standards will present the Agencies with a significant and unnecessary enforcement problem. As the Agencies imply in the text of Question 42, this approach would "encourage covered swaps entities to separate their derivatives activities into multiple entities so as to avail themselves of the exemption". Major banks include thousands of legal entities, some of which may be joint

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<sup>2</sup> E.g. the CFTC has established an initial \$8 billion notional value threshold for designation as a swaps dealer.



ventures with partial ownership.<sup>3</sup> Agencies would be faced with the choice between either permitting large banks to divide their activities between different swaps entities in order to use this exemption, or else using complex aggregation procedures to determine which swaps activities should be ascribed to which banks.

Finally, in response to Question 43, this decision would conflict with the statutory factors the agencies are directed to consider in Sections 731 and 764 of the Dodd-Frank Act. As discussed above, these factors require the Agencies to consider systemic risk generally, not simply the soundness of a limited number of large banks. It has been amply demonstrated in previous financial crises – including the Great Depression and the Savings and Loan Crisis of the 1980s – the collective failure of multiple small entities invested in correlated assets can trigger a systemic crisis. Market regulators have already exempted smaller banks (with assets under \$10 billion) with derivatives holdings below the entity designation thresholds from clearing requirements. An additional exemption from the full application of margin requirements for uncleared swaps would create major incentives to channel large amounts of derivatives activity through smaller entities. This could create significant risk to the broader financial system.

**The Proposed Rule should establish a rebuttable presumption that all bank affiliates are guaranteed for the purposes of cross-border application of derivatives margin requirements:**

The Proposed Rule correctly states that without the application of margin requirements to foreign affiliates of U.S. banks that are guaranteed by the parent company:

“swaps and security-based swaps with a U.S. counterparty could be structured, through the use of an overseas affiliate, in a manner that would evade application of the proposed margin requirements.” [CFR 27581]

This contention is supported by extensive experience and data. Bloomberg News has documented that large Wall Street banks routinely transact well over half of their swaps business through overseas affiliates.<sup>4</sup> Furthermore, these large institutions manage their revenues as integrated global entities, making little distinction based on the locations of gains and losses. As one scholar has stated:<sup>5</sup>

“Despite their corporate complexity, LCFIs [Large Complex Financial Institutions] tend to be managed in an integrated fashion along lines of business with only minimal regard

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<sup>3</sup> Cumming, Christine and Eisenbeis, Robert A., “Resolving Troubled Systemically Important Cross-Border Financial Institutions: Is a New Corporate Organizational Form Required?”, FRB of New York Staff Report No. 457, July 1, 2010.

<sup>4</sup> See Brush, Silla, [“Goldman Sachs Among Banks Lobbying To Exempt Half of Swaps From Dodd Frank”](#), Bloomberg News, January 30, 2012.

<sup>5</sup> Herring, R. and J. Carmassi, 2009, “The Structure of International Financial Conglomerates: Complexity and Its Implications for Systemic Risk,” Chapter 8 in the *Oxford Handbook of Banking*, edited by A. Berger, D. Molyneux, and J. Wilson, Oxford University Press.

for legal entities, national borders or functional regulatory authorities. In most cases, the nominal location of the swaps transaction makes little difference to the risk that transaction poses to the parent company.”

These realities underline the importance of the decision to enforce these margin requirements on international affiliates of U.S. entities. Effective cross-border application of these rules is crucial to maintaining the integrity of global derivatives regulation. The Proposed Rule correctly states that margin requirements must be applied to all transactions involving foreign affiliates of U.S. banks that are guaranteed by the parent company.

However, because of the ubiquitous presence of implicit or assumed guarantees in the financial markets, it can be difficult to tell whether an affiliate is guaranteed. AFR has discussed this issue in detail in a recent comment to the CFTC.<sup>6</sup> Because of this difficulty, AFR recommends that for the purposes of regulating cross-border derivatives regulators establish a rebuttable presumption that all foreign affiliates of major U.S. banks are guaranteed. This presumption could only be rebutted by an affirmative demonstration that the parent had explicitly committed not to support the affiliate, and that customers, counterparties, and the market were aware of this commitment.

**Other Recommendations:** AFR supports Better Markets recommendation that netting procedures must be drawn from the ratios used by Derivatives Clearing Organizations, rather than using the approximations recommended in this Proposed Rule.<sup>7</sup> In the case of uncleared swaps, external providers of information such as Markit can provide specific and customized data and models that reflect the actual correlations to be used in netting calculations.

Thank you for the opportunity to comment on this proposed rule. If you have any further questions, please contact Marcus Stanley, AFR’s policy director, at [marcus@ourfinancialsecurity.org](mailto:marcus@ourfinancialsecurity.org) or (202) 466-3672.

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<sup>6</sup> See pp. 7-10 of [AFR Comment Letter On CFTC Cross Border Guidance](#), August 27, 2012.

<sup>7</sup> See Better Markets, [Comment Letter on Margin and Capital Requirements](#), July 11, 2011.

## **Following are the partners of Americans for Financial Reform.**

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International
- HNMA Funding Company



- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Council of Women's Organizations
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal

- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

#### **List of State and Local Affiliates**

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS



- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY

- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

### **Small Businesses**

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET